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NASHVILLE, TENNESSEE

August 7, 2002

TN REGULATORY AUTHORITY
DOCKET ROOM

IN RE:

RBS GAS UTILITY, INC.

ACTUAL COST ADJUSTMENT (ACA) AUDIT

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) **Docket No. 02-00362**

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**NOTICE OF FILING BY THE ENERGY AND WATER DIVISION OF THE
TENNESSEE REGULATORY AUTHORITY**

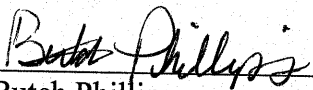
Pursuant to Tenn. Code Ann. §§ 65-4-104, 65-4-111 and 65-3-108, Energy and Water Division of the Tennessee Regulatory Authority (the "Energy and Water Division") hereby gives notice of its filing of the RBS Gas Utility, Inc., ACA Audit Report in this docket and would respectfully state as follows:

1. The present docket was opened by the Authority to hear matters arising out of the audit of RBS Gas Utility, Inc. (the "Company").
2. The Company's ACA filing was received on April 4, 2002 and the Staff completed its audit of same on August 5, 2002.
3. On August 5, 2002, the Energy and Water Division issued its preliminary ACA audit findings to the Company, and on August 5, 2002, the Company responded thereto.
4. The preliminary ACA audit report was modified to reflect the Company's responses and a final ACA audit report (the "Report") resulted therefrom. The Report is

attached hereto as Exhibit A and is fully incorporated herein by this reference. The Report contains the audit findings of the Energy and Water Division, the Company's responses thereto and the recommendations of the Energy and Water Division in connection therewith.

5. The Energy and Water Division hereby files its Report with the Tennessee Regulatory Authority for deposit as a public record and approval of the recommendations and findings contained therein.

Respectfully Submitted:



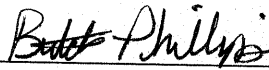
Butch Phillips
Energy and Water Division of the
Tennessee Regulatory Authority

CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of August 2002 a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

Mrs. Sara Kyle
Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

Mr. W.E. Hathorn
President
RBS Gas Utility, Inc.
PO Box 759
Prentiss, MS 39474



Butch Phillips

RBS GAS UTILITY, INC.

**COMPLIANCE AUDIT REPORT OF
ACTUAL COST ADJUSTMENT**

Docket #02-00362

**PREPARED BY:
TENNESSEE REGULATORY AUTHORITY
ENERGY AND WATER DIVISION**

AUGUST, 2002



RBS GAS UTILITY, INC.

**COMPLIANCE AUDIT REPORT OF
ACTUAL COST ADJUSTMENT**

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I. **JURISDICTION AND POWER OF THE TENNESSEE REGULATORY AUTHORITY**

Tennessee Code Annotated (T.C.A.) §65-4-104 gave jurisdiction and control over public utilities to the Tennessee Public Service Commission. By virtue of Chapter 305 of the Public Acts of 1995, jurisdiction and control over public utilities was transferred from the Tennessee Public Service Commission to the Tennessee Regulatory Authority (the "TRA" or "Authority") on July 1, 1996. T.C.A. §65-4-104 states that:

The Authority shall have general supervision and regulation of, jurisdiction, and control over, all public utilities...

T.C.A. states further in §65-4-111 that the public utilities are to maintain a Uniform System of Accounts:

The Authority shall have the power after hearing, upon notice, by order in writing to require every public utility... to keep its books, records, and accounts so as to afford an intelligent understanding of the conduct of its business, and to that end to require every public utility of the same class to adopt a uniform system of accounting. Such system shall conform, where applicable to any system adopted or approved by the Interstate Commerce Commission of the United States. And to furnish annually, or at other times as the Authority may require, a detailed report of finances and operations as shown by said system of accounts.

The TRA responded to T.C.A. §65-4-111 by establishing its own rule 1220-4-1-1.11 regarding the uniform system of accounts which public utilities should maintain. The TRA's rule provides:

The following uniform system of accounting will be followed by utilities and other companies making periodic reports to the Authority:

1. For Classes A and B gas companies - Uniform System of Accounts as adopted by the National Association of Regulatory Utility Commissioners as revised June 30, 1972, and any amendments or revisions pertaining thereto.

The TRA received its authority to examine the books and records of public utilities from T.C.A. §65-4-105 which states that the TRA would possess all the other powers conferred on the TRA. T.C.A. §65-3-108 gives the TRA:

full power to examine the books and papers of the said companies, and to examine, under oath, the officers, agents, and employees of said companies...to procure the necessary information to intelligently and justly discharge their duties and carry out the provisions of this chapter and chapter 5 of this title.

II. **PURPOSE OF COMPLIANCE AUDITS**

The two basic reasons for compliance audits are to assure compliance with the Uniform System of Accounts (USOA) and to assure that the utility is following all rules, regulations and directives adopted by the TRA.

Compliance audits provide the foundation of assurance underlying the basic objective of regulatory accounting, which is to provide a uniform method of recording transactions among similar companies. This uniform record keeping is accomplished through the adoption of the USOA and insures the integrity, reliability, and comparability of the financial data contained in financial reports filed with the TRA, which provides the TRA with one of its most useful regulatory tools for establishing just and reasonable rates.

III. **DESCRIPTION OF PURCHASED GAS ADJUSTMENT (PGA) RULE**

The Tennessee Regulatory Authority issued an Order in Docket No. G-86-1, which adopted a new PGA rule beginning July 1, 1992. The PGA Rider is intended to permit the Company to recover, in a timely fashion, the total cost of gas purchased for delivery to its customers and to assure that the Company does not over-collect or under-collect gas costs from its customers. This PGA consists of three major components:

- 1) **The Actual Cost Adjustment (ACA)**
- 2) **The Gas Charge Adjustment (GCA)**
- 3) **The Refund Adjustment (RA)**

The ACA is the difference between the revenues billed customers by means of the GCA and the cost of gas invoiced the Company by suppliers plus margin loss (if allowed by order of the TRA in another docket) as reflected in the Deferred Gas Cost account. The ACA then "true-up" the difference between the actual gas costs and the gas costs recovered from the customer through a surcharge or a refund. The RA refunds the "true-up" along with other supplier refunds.

For a more complete definition of the GCA and RA, please see the PGA Formula in Appendix A.

IV. **AUDIT TEAM**

The TRA's Energy and Water Division is responsible for conducting ACA audits. The audit was conducted by Butch Phillips of the Energy and Water Division.

V. **OBJECTIVE AND SCOPE OF AUDIT**

The order for Docket G-86-1 required that the Company

each year...shall file with the Authority an annual report reflecting the transactions in the Deferred Gas Cost Account. Unless the Authority provides written notification to the Company within one hundred eighty (180) days from the date of filing the report, the Deferred Gas Cost Adjustment Account shall be deemed in compliance with the provisions of this Rule...

The objective of this audit was to determine that Purchased Gas Adjustments, which are encompassed by the ACA and were described earlier, approved by the TRA during the period from March 1, 2001, to February 28, 2002, had been calculated correctly and were supported by appropriate source documentation. To accomplish this task, the Staff conducted in-house audit work, during which the Company's calculations of gas costs incurred and gas costs recovered were tested.

The Staff also audited a sample of customer bills to determine if the proper PGA rates were being applied in the Company's calculation of the customers' bills. These bills were selected to be representative of the residential, commercial, industrial and interruptible customers in each of the Company's service areas. The sample was selected from all various months of the audit period.

The Staff's last ACA audit of RBS Gas Utility, Inc. was conducted in 2001 covering the period from March 1, 2000 to February 28, 2001.

VI. BACKGROUND INFORMATION ON COMPANY AND GAS SUPPLIERS

RBS Gas Utility, Inc. (Company) services the city of Red Boiling Springs, Tennessee, which is located in Macon County. The Company's corporate office, however, is in Prentiss, Mississippi. As a gas distributor it has approximately 235 customers and an annual sales volume of approximately 28,079 Mcf.

The natural gas used to serve this area is provided through long-term contracts with a nonaffiliated third party that transports gas via the TETCO pipeline to the city gate.

VII. ACA FINDINGS

An ACA filing was submitted by the Company on April 4, 2002, covering the period March 1, 2001 to February 28, 2002. This filing reflected an over-collection of gas costs of \$3,929.42 as of February 28, 2002. The Staff's audit findings showed a net under-collection of gas costs in the amount of \$38.97. This audit adjustment results in a corrected ending balance as of **February 28, 2002 of \$3,890.45 in over-collected gas costs.** The exceptions noted are summarized below.

SUMMARY:

FINDING #1	The Company did not apply the correct ACA factor during July 2001.	\$405.84 under-recovery
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FINDING #2 The Company incorrectly stated the \$366.87 over-recovery interest on account balance.

Net Result **\$38.97** under-recovery

FINDING #1:**Exception**

The Company did not apply the Authority approved Actual Cost Adjustment (ACA) factor during July 2001 of the audit period.

Discussion

The Company used a ACA factor of \$0.8194 during July 2001 of the audit period which was approved in Docket No. 99-00403. The rate that should have been used was (\$.0706). That factor was approved in Docket No. 00-00279. The Company used the correct rate of (\$.0706), as approved, when it billed its customers for that period.

However, because of the error contained in the filing the Staff discovered a difference of \$405.84 in additional under-recovered gas costs that it did not collect.

The associated accrued interest will be discussed in Finding # 2.

Company Response

The company takes no exception to the finding. The company made a cutting and pasting error during the preparation of the report. A more careful review should have been accomplished prior to submitting the filing.

FINDING #2:

Exception

The Company used an incorrect rate during the entire audit period to calculate the interest on the ACA balance. The Company's filing also contained a calculation error which resulted in an incorrect ending ACA balance.

Discussion

The company did not use the correct interest rates for the entire audit period. The Company also did not compound the interest when calculating the final ending balance. The Staff recalculated what the interest portion of the ACA would be if the correct interest rates were used and with all Staff recommended corrections. The total amount of interest to be accrued for the audit period was an over-recovery of \$1,849.93. The Company reported \$1,483.06 in over-recovered interest. The difference results in a \$366.87 (\$50.98 is attributed to the lack of compounding) additional over-recovered interest.

The Company has been cited for not applying the correct interest factor in its prior four ACA audits (Docket No. 98-00441, No. 99-00403, No. 00-00279, and No. 01-00287). The Staff notifies the Company by letter every quarter containing the approved interest rates to be used in ACA calculations. The PGA Rule governing purchased gas adjustments requires that interest be accrued on gas costs (whether under or over recovered).

The previous audit report, in Docket No. 01-00287, noted that RBS had been cited for failure to apply the correct interest rate in the previous three audit reports. The Company's response, quoted in the audit report in Docket No. 01-00287 was as follows:

RBS will take measures to ensure that the correct interest factors are used in the future. We have noted the deficiencies in our filing and internal control weaknesses and have implemented procedures to ensure future compliance.

Notwithstanding the PGA requirement and the assurances of compliance given by RBS in response to the audit report in Docket No. 01-00287, RBS has once again failed to apply the correct interest rate. Staff is concerned that the Company's persistent pattern of applying an incorrect interest rate will continue. Should the Authority approve this audit report, Staff recommends that the Authority instruct RBS that its continued failure to apply the correct interest rate will result in enforcement action by the Authority, including, if necessary, a show cause proceeding and the levying of penalties against the Company.

Company Response

The company takes no exception to the finding.

VIII. CONCLUSIONS AND RECOMMENDATIONS

The Company reported the results of the activity in the Deferred Gas Cost account for the ACA year ended February 28, 2002, as a net over-collection of \$3,929.42. Due to the above findings, this balance was adjusted to a net \$3,890.45 in over-collected gas costs. In order to refund this amount over the next twelve months, Staff recommends the Company include a refund factor on its customers bills of negative **\$.1565 per Mcf (over-recovery)** starting with the **August 2002 billing period**. Except for the above findings, the Purchased Gas Adjustment mechanism, as calculated in the Actual Cost Adjustment, appears to be working properly and in accordance with the Tennessee Regulatory Authority's rules.

APPENDIX A

PGA FORMULA

The computation of the GCA can be broken down into the following formulas:

$$\text{Firm GCA} = \frac{D + \text{DACA}}{\text{SF}} - \text{DB} + \frac{P + T + \text{SR} + \text{CACA}}{\text{ST}} - \text{CB}$$

$$\text{Non-Firm GCA} = \frac{P + T + \text{SR} + \text{CACA}}{\text{ST}} - \text{CB}$$

where

GCA = The Gas Charge Adjustment in dollars per Ccf/Therm, rounded to no more than five decimal places.

D = The sum of all fixed Gas Costs.

DACA = The demand portion of the ACA.

P = The sum of all commodity/gas charges.

T = The sum of all transportation charges.

SR = The sum of all FERC approved surcharges.

CACA = The commodity portion of the ACA.

DB = The per unit rate of demand costs or other fixed charges included in base rates in the most recently completed general rate case (which may be zero if the Company so elects and the Commission so approves).

CB = The per unit rate of variable gas costs included in base rates in the most recently completed general rate case (which may be zero if the Company so elects and the Commission so approves).

SF = Firm Sales.

ST = Total Sales.

The computation of the RA can be computed using the following formulas:

$$\text{Firm RA} = \frac{\text{DR1} - \text{DR2}}{\text{SFR}} + \frac{\text{CR1} - \text{CR2} + \text{CR3} + i}{\text{STR}}$$

$$\text{Non-Firm RA} = \frac{\text{CR1} - \text{CR2} + \text{CR3} + i}{\text{STR}}$$

where

RA = The Refund Adjustment in dollars per Ccf/Therm, rounded to no more than five decimal places.

DR1 = Demand refund not included in a currently effective Refund Adjustment, and received from suppliers by check, wire transfer, or credit memo.

DR2 = A demand surcharge from a supplier not includable in the GCA, and not included in a currently effective Refund Adjustment.

CR1 = Commodity refund not included in a currently effective Refund Adjustment, and received from suppliers by check, wire transfer, or credit memo.

CR2 = A commodity surcharge from a supplier not includable in the GCA, and not included in a currently effective Refund Adjustment.

CR3 = The residual balance of an expired Refund Adjustment.

i = Interest on the "Refund Due Customers" account, using the average monthly balances based on the beginning and ending monthly balances. The interest rates for each calendar quarter used to compute such interest shall be the arithmetic mean (to the nearest one-hundredth of one percent) of the prime rate value published in the "Federal Reserve Bulletin" or in the Federal Reserve's "Selected Interest Rates" for the 4th, 3rd, and 2nd months preceding the 1st month of the calendar quarter.

SFR = Firm sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.

STR = Total sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.

i =	Interest on the "Refund Due Customers" account, using the average monthly balances based on the beginning and ending monthly balances. The interest rates for each calendar quarter used to compute such interest shall be the arithmetic mean (to the nearest one-hundredth of one percent) of the prime rate value published in the "Federal Reserve Bulletin" or in the Federal Reserve's "Selected Interest Rates" for the 4th, 3rd, and 2nd months preceding the 1st month of the calendar quarter.
SFR =	Firm sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.
STR =	Total sales as defined in the GCA computation, less sales under a transportation or negotiated rate schedule.